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IN THE

Supreme Court of the United States

October Term, 1959.

No. ~~1025~~ 165

ESTATE OF JOHN SCHLOSSER, Deceased,
RAYMOND SCHLOSSER, Executor,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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ESTATE OF JOHN SCHLOSSER, DECEASED,
RAYMOND SCHLOSSER, EXECUTOR,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner above-named prays that writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, entered in this case on March 30, 1960, affirming the decision of the Tax Court of the United States, which approved the Federal estate tax deficiency of $21,500.00 determined by the Commissioner of Internal Revenue.

OPINIONS BELOW.

The opinion of the Tax Court is reported in 32 T. C. 262. The opinion of the Court of Appeals has not been officially reported. Both opinions are set forth in Appendix, *infra*, pages 1a to 15a inclusive.

JURISDICTION.

The judgment of the Court of Appeals was entered on March 30, 1960. Jurisdiction to issue the writ prayed for is vested in this Court by Act of June 25, 1948 (62 Stat. 928, 28 U. S. C. 1254).

QUESTIONS PRESENTED FOR REVIEW.

1. Where an executor elects to exercise the option provided in Section 811(j) of the Revenue Code of 1939 to report the assets of the estate in the Federal estate tax return at their values one year after the decedent's death (instead of as of the date of death), must there be included in the gross estate, in addition to the shares owned by the decedent at the date of death, shares received as a stock dividend, declared and capitalized by the corporation eleven months after death?

2. When the Treasury regulations promulgated under the Code provide that ordinary dividends out of earnings and profits, whether in cash or in shares of the corporation, declared to stockholders of record after the date of the decedent's death are excluded property and are not to be valued under the optional valuation method, did not the Court of Appeals, by deciding that shares received as a stock dividend must constitute taxable income to be excluded from the gross estate of the decedent, usurp the functions of the legislative and executive branches of the Government by depriving the estate of the full benefit and relief which Congress and the Treasury intended to afford by the optional valuation provision?

STATUTE AND REGULATIONS INVOLVED.

There is involved Section 811(j) of the Revenue Code of 1939, which reads as follows:

> "Optional Valuation.—If the executor so elects upon his return . . . the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date one year after the decedent's death . . ."

and Treasury regulations 105, of which paragraph (4) of Section 81.11 reads as follows:

> "Stock of a corporation.— . . . Ordinary dividends out of earnings and profits, whether in cash or in shares of the corporation or in other property, declared to stockholders of record after the date of the decedent's death are 'excluded property' and are not to be valued under the optional valuation method. If, however, dividends are declared to stockholders of record after the date of the decedent's death with the effect that the shares of stock at the subsequent valuation date do not reasonably represent the same 'included property' of the gross estate as existed at the date of the decedent's death, such dividends are 'included property' except to the extent that such dividends are out of earnings of the corporation after the date of the decedent's death. For example, if a corporation makes a distribution in complete or partial liquidation to stockholders of record during the optional valuation period, the amount of such distribution received on stock included in the gross estate is itself 'included property,' except to the extent that the distribution was out of earnings and profits since the date of the decedent's death . . ."

STATEMENT OF THE CASE.

At the time of his death on January 25, 1953, decedent was the owner of 10,394 shares of common stock of Sun Oil Company. His estate received 831 shares of common stock of Sun Oil Company as a stock dividend on December 15, 1953, eleven months after the date of death. The Company had earnings of $45,153,602 in 1953, and the cash dividends and stock dividend of December 15, 1953 (capitalized at $65 per share) paid in 1953 amounted to $44,414,740, thereby increasing earned surplus by $738,862 during the estate's interim period (Appendix, *infra*, page 5a).

It was always the policy of Sun Oil Company to pay a stock dividend. From 1925 to 1953, the Company declared and distributed a stock dividend ranging from 3 per cent to 10 per cent (Appendix, *infra*, page 5a).

The additional shares received eleven months after death were not included in the gross estate as reported in the Federal estate tax return filed by the petitioner as executor. The Commissioner of Internal Revenue on audit of the return held that such additional shares should be included in the gross estate and based on such holding the respondent determined a deficiency in the estate tax of $21,560.00. The Tax Court approved the deficiency determined by the Commissioner and on petition to review the decision of the Tax Court under Section 1141(a) of the 1939 Revenue Code, the Circuit Court affirmed.

REASONS FOR GRANTING WRIT.

1. The decision of the Court of Appeals is an unwarranted limitation of the Revenue Code and Regulations relating to estate taxation.

In the usual case, property of the decedent is valued as of the date of death, and it is settled that, in such case, income earned after death is not to be included therein. If the option granted by Section 811(j) of the Revenue Code is exercised, the same property is to be valued as of one year after the decedent's death. So far as the language of the Code is concerned, there is no more ground for treating the income after death as a part of the estate in one case than in the other. Moreover, this Court, 19 years ago, determined that Congress did not intend, in providing for two dates of valuation, a different method should be followed if one date is chosen rather than the other (*Maass v. Higgins*, 1941, 312 U. S. 443). This case settled the question of excluding from the gross estate of a decedent income (dividends) received by the estate between the date of death and one year after death, or during the optional valuation period. Following the decision of this Court, Treasury regulations were promulgated to provide that "ordinary dividends out of earnings and profits, whether in cash or in shares of the corporation or in other property, declared to stockholders of record after the date of the decedent's death are 'excluded property' and are not to be valued under the optional valuation method." The express language of the Code and regulations excludes from the estate any property, whether capital or income, not a part of the decedent's estate on the date of his death.

In the instant case, the cash dividends received during the interim period and the stock dividend received eleven months after death were ordinary dividends paid in the regular course of business, and the company had con-

sistently declared and issued stock dividends on its common stock averaging from 3 per cent to 10 per cent from 1925 to 1953 (Appendix, *infra*, page 5a). The Commissioner and the Courts below determined that the income comprising the cash dividends were properly excluded from the year-end valuation of the decedent's estate (Appendix, *infra*, pages 8a and 17a), but held that the income comprising the stock dividend should be included in the year-end valuation of the estate, on the authority of *Eisner v. Macomber*, 1920, 252 U. S. 189. The Court of Appeals declared that in its view the quoted regulation is not applicable to the instant case and declared "to be excluded under that regulation dividends must be both 'ordinary' and 'out of earnings and profits,' a description which aptly describes only such distributions as would constitute income to the recipient. The normal cash dividend is of the described type. So are stock dividends which change the stockholder's proportionate interest in the corporation or give him something different in kind from his original stock." The Court's conclusion that the stock dividend received by the estate during the interim period must be taxed, either as income or under the estate provisions, is contrary to and an unwarranted limitation of the plain language of the Code and the Treasury regulation relating to estate taxation, depriving the estate of the full benefit and relief which Congress and the regulation intended by the optional valuation provision. It will be observed that the Code and regulations have been in effect for 21 years, and that it is the function of Congress to change the law.

2. The decision seeks to tax principal on hand one year after death contrary to the Code and regulations.

While this Court has held that stock dividends (shares of common stock upon common stock) are not income (*Eisner v. Macomber*, *supra*), that is no reason for treating such dividends declared after the date of death as part

of the decedent's estate at the time of his death. Moreover, that case involved Federal income taxation and, on basis of book value (capital and surplus divided by the number of shares outstanding), this Court declared that a stockholder's interest in a corporation is not changed by the distribution of a stock dividend, i.e., the new certificates increase the number of shares with consequent dilution of the value of each share. However, the case should have no application to Federal estate taxation, for the reason that in estate taxation the market value, and not book value, of the shares either on date of death or one year after death is the measure or basis for valuation (Section 81.10, Regulations, Appendix, *infra*, page 7a). Here the market value of Sun Oil Company one year after death was $70.1875 per share, and the market value of 11,225 shares (10,394 shares owned at the time of death plus the 831 shares received as a stock dividend eleven months later) or $787,854.69 is not the same as the market value of 10,394 shares or $729,528.88. The new certificates for the stock dividend increased the number of the original shares by 831. For income taxation, the market value per share is adjusted, which is not here germane. For estate taxation, the market value per share remains firm at $70.1875. The difference in the aggregate market value of $58,325.81 has resulted in the estate tax deficiency in this case. However, the provisions of the Code and the regulations do not tax whatever principal may be on hand one year after death but tax the assets one year later which were included in the gross estate on the date of death.

3. The decision is in conflict with the decision of the Court of Appeals for the Fifth Circuit.

Both the decisions in the instant case and in *McGehee v. Commissioner*, 1958, 260 F. 2d 818 (Fifth Circuit), involve Federal estate taxation. In the *McGehee* case, the Commissioner in taxing a transfer in contemplation of death included in the decedent's gross estate stock

dividends which had been declared after the date of the transfer but before the date of death. The same contentions were raised in that case by the Commissioner and the same decision was made by the Tax Court, namely, that the stock dividends did not change the shareholder's interest in the company. The Court of Appeals in that case reversed the Tax Court and made the following comment: "It is the interest of the decedent of which a transfer has been made which is to be included in the taxable estate of the donor. It seems unnecessary to decide whether the subject matter of the transfer was regarded as a 'proportionate interest in the corporation, its business and its assets,' as the Tax Court held it to be, or as 'specific shares of stock' which the Tax Court held it was not. The stock dividends were declared out of profits of the corporation earned subsequent to the gifts and hence were not a proportionate part of the corporation's assets at the time of the gift. This being so, it follows that the deceased donor never had any interest in the shares which were distributed as stock dividends or in the corporate earnings which the dividends capitalized." (*McGehee v. Commissioner, supra*, page 820).

The reasoning applies to the instant case. The decedent could not have had any interest in the stock dividend on the date of his death, because at that time the earnings which were capitalized to create this dividend were not yet in existence. The Court of Appeals in the instant case is clearly in error in disagreeing with the *McGehee* case. In endeavoring to apply the principle of an income tax case to an estate tax case, it is illogical to say that a stock dividend declared and capitalized from profits earned after the date of death was a part of the gross estate on the date of death.

CONCLUSION.

For all of the foregoing reasons and particularly to resolve the conflict between Circuits, so that all estates may not be deprived of the full benefits originally intended by Congress and the Treasury under the optional valuation provision, this petition for writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

FINDINGS OF FACT AND OPINION OF THE TAX COURT OF THE UNITED STATES.

32 T. C. 262.

TAX COURT OF THE UNITED STATES

ESTATE OF JOHN SCHLOSSER, Deceased, RAYMOND SCHLOSSER, Executor, *Petitioner*, *v.* COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Docket No. 63904 Filed April 30, 1959

At the time of his death, January 25, 1953, decedent was the owner of 10,394 shares of common stock of Sun Oil Company. The executor of the estate elected to have the gross estate valued in accordance with values as of January 25, 1954, one year subsequent to decedent's death, as authorized by section 811(j), Internal Revenue Code of 1939. On October 20, 1953, Sun Oil Company declared a stock dividend of 8 shares of its common stock for each 100 shares of common stock then owned by its stockholders. It was also provided that said stock when issued should be charged against the surplus of the company. Sun Oil Company had in 1953, subsequent to decedent's death, earnings in excess of the amount of cash dividends which it paid and the amount which it charged to capital account when such stock dividend was capitalized. The estate of decedent received on December 15, 1953, a stock dividend of 831 shares of common stock of Sun Oil Company pursuant to such declaration of dividend.

The Commissioner in his determination of the deficiency has included the value of these 831 shares, as well as the 10,394 shares owned by decedent at the time of his death, as property to be included on the valuation date, January 25, 1954. *Held*, the Commissioner is sustained under the provisions of section 811 (j), 1939 Code, and the Treasury regulations pertaining to property to be included on the alternative valuation date.

Vernon L. Stover, Esq., for the petitioner.

William C. Baskett, Esq., for the respondent.

The Commissioner has determined a deficiency in petitioner's estate tax of $21,150. The deficiency is due to an increase of $58,325.81 in the value of the stock in Sun Oil Company returned as part of decedent's gross estate. The adjustment is explained in the deficiency notice as follows:

> The stock dividend of 831 shares at $70-3/16 per share of Sun Oil Company no par common stock is includible in gross estate for optional valuation purposes. Section 811(j), 1939 Code.

By appropriate assignments of error petitioner contests the correctness of this adjustment made by the Commissioner.

FINDINGS OF FACT

Most of the facts have been stipulated and the stipulation of facts is incorporated herein by this reference.

The petitioner is the estate of John Schlosser, deceased; Raymond Schlosser is the executor of the estate, with residence at Chester Springs, Pennsylvania.

The decedent, John Schlosser, died a resident of Delaware County, Pennsylvania, on January 25, 1953. Petitioner elected to have the gross estate of the decedent valued in accordance with values as of January 25, 1954, 1 year

subsequent to the decedent's death, as authorized by section 811 (j).[1]

The decedent at the time of his death was the owner of 10,394 shares of common stock of Sun Oil Company, hereinafter sometimes referred to as Sun Oil. The common stock of Sun Oil had a value of $70.1875 per share on January 25, 1954.

At the meeting of the board of directors of Sun Oil held on October 20, 1953, resolutions were adopted with respect to a stock dividend to be issued on December 15, 1953, part of which reads as follows:

> RESOLVED, That out of the authorized, unissued Common Stock of the Company a stock dividend be and the same is hereby declared to be issued on December 15, 1953, to the holders of Common Stock of the Company of record at the close of business November 13, 1953, in proportion to their respective holdings of Common Stock on that date, at the rate of eight (8) shares of Common Stock for each one hundred (100) shares then held, said stock when so issued to be full-paid and non-assessable, and
>
> BE IT FURTHER RESOLVED, That said stock when so issued be charged against the surplus of the Company at the rate of Sixty-five Dollars ($65.00) per share. . . .

The common stock of Sun Oil is listed on the New York Stock Exchange and the Philadelphia Stock Exchange. By applications to the New York Exchange and the Philadelphia Stock Exchange, dated October 20, 1953, Sun Oil applied for the listing of 567,948 additional shares of its common stock and stated that the authority for and purpose of issue were:

> The above 567,948 shares of said stock are to be issued as a stock dividend pursuant to a resolution

1. All section references are to the Internal Revenue Code of 1939, unless otherwise noted.

> of the Board of Directors adopted at a meeting of the Board duly called and held on the 20th day of October, 1953, declaring a stock dividend on the Common Stock at the rate of eight shares per hundred shares held, payable December 15, 1953, to stockholders of record at the close of business November 13, 1953. Said stock, when issued, will be charged against the earnings employed in the business of the Company at the rate of $65.00 per share. . . .
>
> Estimated earnings for the year ending December 31, 1953, will approximate the aggregate of the assigned value ($65.00 per share) of the capital stock to be issued in payment of this stock dividend, and the cash dividends disbursed or to be disbursed during such period. . . .

On December 15, 1953, the petitioner received a stock dividend of 8 per cent on the 10,394 shares of Sun Oil, or 831 shares of common stock.

By letter dated December 15, 1953, the treasurer of Sun Oil advised the holders of common stock that the amount of $36,916,620, based upon 567,948 shares at $65 per share, would be transferred from earnings to the common stock account and that "estimated earnings for the year ending December 31, 1953, will approximate the aggregate of the assigned value of the capital stock to be issued in payment of this stock dividend and the cash dividends disbursed during such period."

The annual report of Sun Oil for 1953 discloses that earnings employed in the business on January 1, 1953, amounted to $57,848,351, and that the net income for the year 1953 amounted to $45,153,602, making a total of $103,001,953, against which there was charged for cash dividends $7,506,336 and, for the 8 per cent stock dividend issued on December 15, 1953, $36,908,404, or a total of $44,414,740, leaving employed in the business on December 31, 1953, earned surplus of $58,587,213.

The policy of the New York Stock Exchange in authorizing the listing of the additional shares of Sun Oil distributed as a stock dividend on December 15, 1953, required that (1) in respect of each such additional share there be transferred from earned surplus to the permanent capitalization of Sun Oil an amount equal to the fair value of such share, and (2) the undistributed earnings of the period between successive distributions be sufficient to cover such aggregate fair value.

In respect to the stock dividend issued on December 15, 1953, Sun Oil complied with the policy of the New York Stock Exchange and transferred $65 per share from earned surplus to its common stock account or permanent capitalization, and its earnings between December 15, 1952 (date of the immediate prior distribution of a stock dividend), and December 15, 1953, amounting to $45,153,602, were more than sufficient to cover the aggregate fair value of the stock dividend of December 15, 1953, and the cash dividends paid in 1953, or a total of $44,414,740.

A stock dividend was also paid or distributed by Sun Oil on December 15, 1952.

Sun Oil has declared and issued stock dividends on its common stock averaging from 3 per cent to 10 per cent from 1925 to 1953.

It has been stipulated that the deficiency of $21,150 determined by the Commissioner is subject to credit for state estate, inheritance or succession taxes upon submission of proof of payment.

OPINION

BLACK, *Judge:* We have here only one issue to decide. That issue is whether, where the executor avails himself of the option granted by section 811 (j) to value the decedent's gross estate as of 1 year after the decedent's death, the value of 831 shares of Sun Oil received as a stock dividend during the year is to be included in the value of the gross estate.

The facts have been fully stated in our Findings of Fact and it is unnecessary to repeat them here.

Section 811 (j), the applicable statute, is printed in the margin.[2]

Petitioner, in support of its contention that the value of the stock dividend paid on stock of Sun Oil after the decedent's death and during the optional valuation period is not includible in decedent's gross estate under section 811 (j), argues in its brief as follows:

> Respondent here overlooks entirely the fact that the value of stocks, within the meaning of the Internal Revenue Code, is the fair market value per share on the applicable valuation date (section 81.10), and that the 10,294 shares included in the inventory or gross estate as of the date of decedent's death are not the same as 11,225 shares (under Federal law, the 10,394

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2. Sec. 811. Gross Estate.

* * * * *

(j) Optional Valuation.—If the executor so elects upon his return (if filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law), the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date one year after the decedent's death, except that (1) property included in the gross estate on the date of death and, within one year after the decedent's death, distributed by the executor (or, in the case of property included in the gross estate under subsection (c), (d), or (f) of this section, distributed by the trustee under the instrument of transfer), or sold, exchanged, or otherwise disposed of, shall be included at its value as of the time of such distribution, sale, exchange, or other disposition, whichever first occurs, instead of its value as of the date one year after the decedent's death, and (2) any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time. No deduction under this subchapter of any item shall be allowed if allowance for such item is in effect given by the valuation under this subsection. Wherever in any other subsection or section of this chapter, reference is made to the value of property at the time of the decedent's death, such reference shall be deemed to refer to value of such property used in determining the value of the gross estate. * * *

shares are corpus, and the 831 shares are nontaxable income) on hand one year after death. Petitioner could not truthfully have sworn that the decedent owned the 831 shares on January 25, 1953, which the Company chose to distribute to the petitioner on December 15, 1953, at the rate of 8 shares for each 100 shares then held, and capitalized earnings which accrued during the optional period.

Section 81.10 to which petitioner refers in the above quotation from its brief is section 81.10 of Regulations 105 and is printed in the margin.[3]

Petitioner, in support of its contention that the 831 shares of Sun Oil stock which petitioner received as a stock dividend on December 15, 1953, is not includible property on the January 25, 1954, valuation date, relies chiefly on the Supreme Court decision in *Maass v. Higgins*, 312 U. S. 443. We do not think that case is applicable here. That case held that rents, royalties, interest or dividends which had not accrued at the time of decedent's death but which accrued and were received after his death were not includible for valuation purposes where the executor had

3. Section 81.10. Valuation of property.—*(a) General.*—The value of every item of property includible in the gross estate is the fair market value thereof at the time of the decedent's death; or, if the executor elects in accordance with the provisions of section 81.11, it is the fair market value thereof at the date therein prescribed or such value adjusted as therein set forth. * * * Such value is to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of the property. For example, in the case of shares of stock or bonds, such unit of property is a share or a bond. All relevant facts and elements of value as of the applicable valuation date should be considered in every case.

* * * * * * *

(c) Stocks and bonds.—The value of stocks and bonds, within the meaning of the Internal Revenue Code, is the fair market value per share or bond on the applicable valuation date.

In the case of stocks and bonds listed on a stock exchange the mean between the highest and lowest quoted selling prices on the valuation date shall be considered as the fair market value per share or bond. * * *

elected to value the estate 1 year after decedent's death. The dividends involved in *Maass v. Higgins, supra,* were cash dividends which had been declared and paid after decedent's death.

In the instant case the facts show that in the year 1953, following decedent's death, Sun Oil paid cash dividends of $7,506,336 out of its earnings for that year. Presumably, petitioner received its part of those cash dividends by reason of its ownership of the 10,394 shares which decedent owned at the time of his death. It is assumed that the reason why no mention is made in the stipulation of facts as to the amount of cash dividends which petitioner received on these 10,394 shares in 1953 is because the Commissioner has made no attempt to include them as a part of decedent's estate on the valuation date. Under section 81.11, Treasury Regulations 105, promulgated after the Supreme Court's decision in *Maass v. Higgins, supra,* these cash dividends clearly would not be includible property as of the date of decedent's death and the Commissioner has made no attempt to include them. He does not argue that they should be included.

In section 18.47 of Paul's Federal Estate and Gift Taxation, Vol. II, the author, under the heading "The Treatment of the Income of Estates where the Optional Valuation Date is Used," discusses the Treasury regulations here applicable. The author, after discussing several situations which may arise under the applicable regulations but which are not pertinent here, then turns his attention to the payment of a stock dividend declared and paid after decedent's death. Of this, he says:

> Another problem to be considered in connection with stock under the optional valuation statute is the effect of a "true" stock dividend, that is, one which does not give a stockholder "an interest different from that which his former stockholdings represented." Under the rule of *Eisner v. Macomber,* . . . a dividend of this kind, as, for example, shares of common

upon common, is not taxable income. "The new certificates simply increase the number of the shares, with consequent dilution of the value of each share." Logically, it should follow that such dividends, if declared during the interim one-year period, should be taxed together with the underlying shares, if the later valuation date is chosen. The dividends do not constitute income to the estate but represent a readjustment of the stockholder's interest. The aversion to double taxation, displayed by the Court in the *Maass* case, has nothing to feed upon in this situation, at least as long as *Eisner v. Macomber* remains good law.

Petitioner argues that the payment of the stock dividend here involved should be treated the same as if it had been a dividend paid in cash because Sun Oil had sufficient earnings in 1953 to have paid the dividend in cash if it had desired to do so, and its action in capitalizing these earnings when the stock dividend was declared and paid makes the situation different from an ordinary stock split and should be treated the same as a cash dividend. We do not agree with this contention.

In *Estate of Delia Crawford McGehee*, 28 T. C. 412, we had before us a case where the decedent in her lifetime had in 1947, 1948, and 1949 transferred a total of 774 shares of stock of the Jacksonville Paper Company in contemplation of death. There was no controversy but that these shares had been transferred in contemplation of death. Later, certain stock dividends were paid on these shares of stock to the transferees prior to decedent's death and the question was whether the value of these stock dividend shares should be included in decedent's gross estate along with the 774 shares which the estate conceded should be included in the gross estate. The Commissioner had included them in his determination of an estate tax deficiency and we sustained the Commissioner. In sustaining him, we said:

> At the time of transfer each share of stock represented to the decedent a corresponding interest in the corporation proportionate to the whole of the corporate business. Stock dividends on those shares would in no way change the stockholder's interest in the corporation. And it would make no difference whether the stock dividend represented a "capitalization of earnings" or a "stock split." (The petitioner here seeks to draw such a distinction.) *Eisner v. Macomber*, 252 U. S. 189. True it is that after the stock dividend each share represented a smaller proportionate interest, but, in toto, they still represented the original interest in the corporation which the decedent owned and had transferred. That interest had simply been further splintered or atomized. In no way had it been increased or diminished and if we look to its value as of the time of death, the value of all the shares represents the value of the interest transferred.

We were reversed by the Fifth Circuit in that case, see *McGehee v. Commissioner*, 260 F. 2d 818. Petitioner in its brief strongly relies for its support of its contention here upon the court's opinion in reversing us in the *McGehee* case. The question in the *McGehee* case is not the same as the question we have before us here. Here, we have a specific statute prescribing the general method of valuation which shall be used on the alternate valuation date and a comprehensive Treasury regulation covering methods to be used when the estate has elected to value 1 year subsequent to decedent's death.

Section 81.11 of Treasury Regulations 105 is printed in the margin.[4] It is under these regulations that the Com-

4. Sec. 81.11. Optional valuation date.—In general, the object of subsection (j) of section 811 is to make provision whereby the amount of tax otherwise payable may be lessened when, within the year following the decedent's death, the gross estate has suffered a shrinkage in its aggregate value.

The executor may, by an election upon his return, Form 706, if filed within the time prescribed by law or prescribed by the Com-

missioner has determined that the 831 shares which petitioner received December 15, 1953, as a stock dividend on

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missioner in pursuance of law, have the property which was included in the gross estate on the date of the decedent's death valued as of the applicable dates, as follows:

* * * * *

(b) Any property not distributed, sold, exchanged, or otherwise disposed of within such 1-year period, valued as of the date one year after the date of decedent's death;

* * * * *

In valuing the gross estate under the optional valuation method, all of the property interests existing at the date of death which are a part of the gross estate as determined under the subsections of section 811 constitute the property to be valued as of one year after the date of the decedent's death, or as of the date of the decedent's death, or as of some intermediate date. Such property is hereinafter referred to as "included property." "Included property" as of the date of the decedent's death remains "included property" for the purpose of valuing the gross estate under the optional valuation method even though it is changed in form during the optional valuation period by being actually received, or disposed of, in whole or in part, by the estate. However, property earned or accrued (whether received or not) after the decedent's death and during the optional valuation period with respect to any property interest existing at the date of death, which does not represent a form of "included property" itself or the receipt thereof, is to be excluded in valuing the gross estate at the subsequent valuation date and is hereinafter referred to as "excluded property." Among the items of "included property" to be valued in accordance with these principles are the following:

* * * * *

(4) *Stock of a corporation.*—Shares of stock in a corporation and dividends declared to stockholders of record on or before the date of the decedent's death and not collected at the date of death constitute "included property" of the estate. Ordinary dividends out of earnings and profits, whether in cash or in shares of the corporation or in other property, declared to stockholders of record after the date of the decedent's death are "excluded property" and are not to be valued under the optional valuation method. If, however, dividends are declared to stockholders of record after the date of the decedent's death with the effect that the shares of stock at the subsequent valuation date do not reasonably represent the same "included property" of the gross estate as existed at the date of the decedent's death, such dividends are "included property" except to the extent that such dividends are out of earnings of the corporation after the date of the decedent's death. For example, if a corporation makes a distribution in complete or partial liquida-

the 10,394 shares which decedent owned at the time of his death were "included property" within the meaning of the foregoing regulation. In discussing the foregoing regulation respondent says in his brief:

> It is the contention of the respondent that unless the stock dividend in the instant case is included in the decedent's gross estate as of the optional valuation date, the shares of stock will not reasonably represent the "included property" at the death of the decedent.
> . . .

In Rev. Rul. 58-576, I. R. B. 1958-47, 14-16, a ruling is made with respect to: "Valuation to be used where the executors of an estate elect the alternate valuation method under section 2032 of the Internal Revenue Code of 1954 in certain factual situations involving stock rights, stock dividends, insurance proceeds, and interest bearing obligations received or disposed of within the year following the decedent's death." It should be pointed out here that section 2032, Internal Revenue Code of 1954, referred to above is substantially the same as section 811 (j). In the ruling which we are now discussing it is stated among other things, as follows:

> Property which is "included property" as of the date of the decedent's death remains "included property" for the purpose of valuing the gross estate under the optional valuation method even though it is changed in form during the optional valuation period by being actually received, or disposed of, in whole or in part, by the estate. However, property earned or accrued (whether received or not) after the decedent's death and during the alternate valuation period with respect

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tion to stockholders of record during the optional valuation period, the amount of such distribution received on stock included in the gross estate is itself "included property," except to the extent that the distribution was out of earnings and profits since the date of the decedent's death. * * *

to any property interest existing at the date of death, which does not represent a form of "included property" itself or the receipt thereof, is to be excluded in valuing the gross estate at the subsequent valuation date and is referred to as "excluded property."

The factual situations with respect to which advice is requested are as follows:

* * * * *

Situation No. 3.

Additional stock received as a result of a stock dividend before the year expires, but after the death of the decedent.

Answer.

A stock dividend which is not income within the meaning of the Sixteenth Amendment to the Constitution received subsequent to the decedent's death must be included in the gross estate where the alternate valuation method has been elected. The declaration of the stock dividend after the decedent's death directly affects the value of the shares of stock at the subsequent valuation date so that the decedent's shares of stock in the corporation at the subsequent valuation date no longer reasonably represent the same property interest in the corporation possessed by the decedent at the time of his death. Such a dividend is "included property" as that term is defined in section 20.2032-1 of the regulations.

While it is, of course, true that a revenue ruling such as the one from which we have just quoted is not binding upon us in the interpretation of the statute to which it pertains, nevertheless in the instant case, after a careful examination of the statutes and the Treasury regulations involved, we think the foregoing ruling as to how a stock dividend shall be treated under the alternate valuation method is correct.

We, therefore, sustain the Commissioner in his determination. The decision hereunder should be entered under Rule 50 since administrative adjustments of the deficiency will be necessary as pointed out in the stipulation.

Reviewed by the Court.

Decision will be entered under Rule 50.

DECISION.

Pursuant to the Findings of Fact and Opinion of the Court filed April 30, 1959, the parties on June 17, 1959, having filed an agreed computation of the tax, now therefore, it is

ORDERED and DECIDED: that there is a deficiency in estate tax in the amount of $21,150.00.

(Signed) EUGENE BLACK
Judge

Enter: June 22, 1959.

APPENDIX B.

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 13,055

ESTATE OF JOHN SCHLOSSER, DECEASED;
RAYMOND SCHLOSSER, EXECUTOR,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR REVIEW OF A DECISION OF THE TAX COURT OF THE UNITED STATES

Argued February 4, 1960

Before GOODRICH, HASTIE and FORMAN, *Circuit Judges.*

(Filed March 30, 1960)

By HASTIE, *Circuit Judge.*

This is an estate tax case in which the petitioning executor chose, as authorized by Section 811 (j) of the Internal Revenue Code of 1939,[1] to value the gross estate of the

1. The subsection reads:

"(j) *Optional Valuation.* If the executor so elects upon his return (if filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law), the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date one year after the decedent's death, . . ." 26 U.S.C., 1952 ed. § 811(j).

decedent by valuing "the property included therein on the date of decedent's death as of the date one year after the decedent's death". The question is whether a true stock dividend which was declared during the year immediately following decedent's death should be included in the executor's year-end valuation of the decedent's stock for estate tax purposes. The tax court held that the stock dividend was includable. 32 T. C. 262. The executor has brought that decision here for review.

The decedent died owning some 10,000 shares of common stock of the Sun Oil Company. A few months later the Board of Directors of that corporation passed the following resolution:

> "Resolved, That out of the authorized, unissued Common Stock of the Company a stock dividend be and the same is hereby declared to be issued on December 15, 1953, to the holders of Common Stock of the Company of record at the close of business November 13, 1953, in proportion to their respective holdings of Common Stock on that date, at the rate of eight (8) shares of Common Stock for each one hundred (100) shares then held, said stock when so issued to be full-paid and non-assessable, and
>
> "Be It Further Resolved, That said stock when so issued be charged against the surplus of the Company at the rate of Sixty-five Dollars ($65.00) per share . . . ."

This resolution was duly carried out by the distribution of eight authorized but theretofore unissued shares of common stock for each 100 issued and outstanding shares of common. At the same time a corresponding increase in permanent capitalization was achieved by the transfer of $65. for each such newly issued share from earned surplus to the common stock account.

The surplus as determined, after the stockholder's death, at the beginning of the year during which the divi-

dend was declared was sufficient to cover both this stock dividend and a cash dividend declared in the same year. There were additional earnings during the year of the dividend and before its declaration, but the present record indicates that these additional earnings were somewhat less than the sum of the currently declared stock and cash dividends. However, as we view the case nothing turns on this point.

It is not disputed that the cash dividend was current income of the estate and as such was properly excluded from the year-end valuation of the decedent's stock. *Maas v. Higgins*, 1941, 312 U. S. 443. In contrast, however, the Commissioner says and the tax court has agreed that the true stock dividend of proportional amounts of common stock distributed to all common stockholders is not in legal contemplation new property of the estate but rather is a further fractionalizing of existing stock ownership, reflecting merely an appreciation in the value of the old property.

We think the analysis made by the Commissioner and the tax court is correct. Indeed, it is a logical consequence of the doctrine of *Eisner v. Macomber*, 1920, 252 U. S. 189. There a true stock dividend was held to be insufficiently differentiated from the capital stock which the stockholder already owned to be income. Here, by the same token, such a dividend cannot be said to constitute new property distinct from the stock owned when the dividend was declared. In neither case is it significant that additional certificates have been issued. For the ownership rights embodied in the larger number of certificates are identical with those represented by the original stock. The true stock dividend has "merely changed the form of the estate's investment—by increasing the number of its shares." See *McDonald v. Maxwell*, 1927, 274 U. S. 91, 98. There has been no step toward the severance or distribution of part of the corporate estate.

Admittedly, the recent undistributed earnings of the corporation which underlay the stock dividend could be con-

sidered new property to the corporation. But unless the corporate entity be ignored, such accessions to the corporate estate benefit the stockholder only as an increase in the value of his stock. In the absence of any dividend it would not even be argued that the corporate veil be pierced or that a stockholder acquires new property when the corporation earns a profit or accumulates a surplus. The only noteworthy additional circumstance involved in the issuance of a true stock dividend is the transfer of corporate accumulations from surplus to permanent capitalization, the very antithesis of transforming corporate property into property of the stockholder. Thus, the economic advantage of corporate earning to the stockholder, whether viewed before or after its translation into a true stock dividend, cannot rationally be analysed as vesting in the stockholder any new property. See 2 Paul, Federal Estate and Gift Taxation, 1942, 1342-43. To the extent that contrary implications appear in *McGehee v. Commissioner*, 5th Cir. 1958, 260 F. 2d 818, a controversy concerning a stock dividend on capital stock which had been transferred in contemplation of death, upon which the executor relies, we disagree with that case.

This analysis also suggests the answer to a separate contention of the executor that a Treasury Regulation concerning the method of valuing stock in a decedent's estate a year after the owner's death authorizes the exclusion of such a stock dividend as we have here. Section 81.11 of Treasury Regulation 105, promulgated under the Internal Revenue Code of 1939, does say that "ordinary dividends out of earnings and profits, whether in cash or in shares of the corporation or in other property, declared to stockholders of record after the date of the decedent's death are 'excluded property' and are not to be valued under the optional valuation method."

In our view the quoted regulation is not applicable to this case. To be excluded under that regulation dividends must be both "ordinary" and "out of earnings and profits", a description which aptly describes only such dis-

tributions as would constitute income to the recipient. The normal cash dividend is of the described type. So are stock dividends which change the stockholder's proportionate interest in the corporation or give him something different in kind from his original stock. See, for example, the situation analysed in *Koshland v. Helvering*, 1936, 298 U. S. 441. But, as has been pointed out, we are now concerned with a kind of dividend which is attended, not by any step toward severance of earnings and profits from the corporate estate, but rather by the antithetical process of adding to the permanent capitalization. And the stockholder has nothing of significance after the dividend has issued which he did not have before. It therefore seems correct to say that the present kind of stock dividend is not "ordinary" and "out of earnings and profits", within a reasonable construction of the regulation.

For these reasons the judgment of the Tax Court will be affirmed.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 13,055.

ESTATE OF JOHN SCHLOSSER, DECEASED;
RAYMOND SCHLOSSER, EXECUTOR,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES.

Present: GOODRICH, HASTIE and FORMAN, *Circuit Judges.*

JUDGMENT.

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

March 30, 1960

Attest:

IDA O. CRESKOFF,
Clerk.